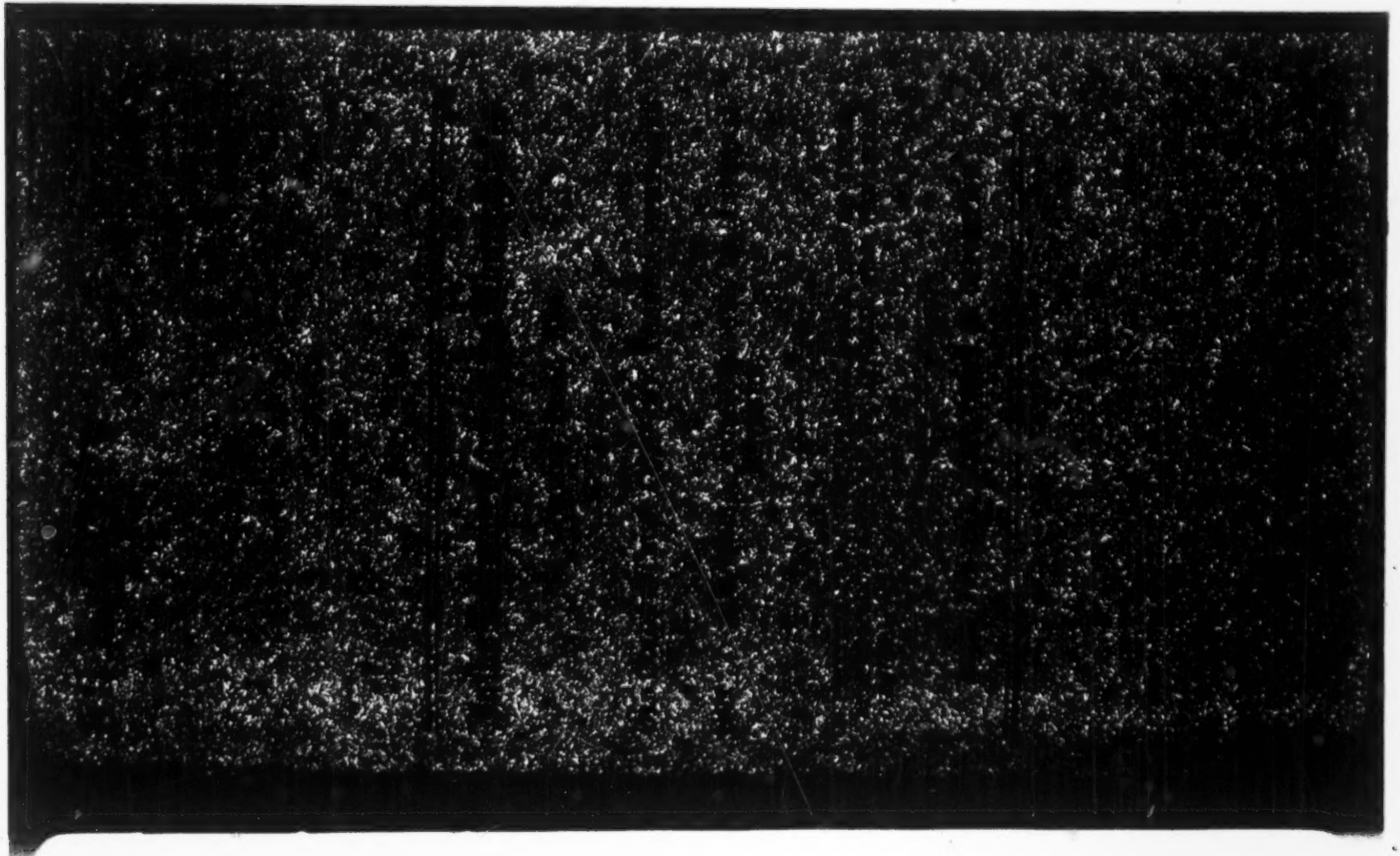

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In the Supreme Court of the United States

OCTOBER TERM, 1936

No. 703

OLD COLONY TRUST COMPANY, TRUSTEE, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIRST CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 56–66) is reported at 33 B. T. A. 311. The opinion of the Circuit Court of Appeals (R. 87–94) has not yet been officially reported.

JURISDICTION

The judgment of the Circuit Court of Appeals for the First Circuit was entered December 10, 1936. (R. 95.) The petition for writ of certiorari was filed February 4, 1937. The jurisdiction

of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The only question presented is whether the Circuit Court of Appeals erred in holding that the petitioner is not entitled to deduct from its gross income, in computing its taxable net income for the year 1931, certain amounts paid during the year to exempt religious, charitable or educational corporations.

STATUTE AND REGULATIONS INVOLVED

The statute and regulations involved will be found in the Appendix, *infra*, pp. 14–18.

STATEMENT

The facts were stipulated before the Board of Tax Appeals (R. 22–56).

Henry Clay Jackson, of Boston, Massachusetts, died intestate, leaving Paul Wilde Jackson, a brother, as his sole heir. (R. 28.) Paul Wilde Jackson, apparently to carry out certain wishes of his brother, executed a deed of trust under date of July 19, 1922 (R. 28–35), whereby he conveyed to the petitioner, as trustee, all of his right, title and interest in and to the property of Henry Clay Jackson remaining after payment of debts and other charges against the estate (R. 23).

The deed of trust, after providing for present distribution of a part of the property transferred and for the payment of stated annuities to a number of individuals, some of whom were still living during the taxable year involved, contained the further provision (R. 33–34):

> 13. I authorize my said trustees to pay to charities as hereinafter described such sums as in their judgment may be paid without jeopardizing the annuities herein provided for, whenever for a period of one year the trust fund held by them as then invested shall have yielded a net income equal to twice the amount of the annuities which they are then required to pay, and upon the death of the survivor of those persons, who under the terms of this instrument are to receive annual incomes under the trust hereby created, I direct my said trustees to distribute the rest and residue remaining in their hands among corporations and trustees organized, operating and holding exclusively for religious, charitable, scientific, literary or educational purposes, including the encouragement of art and the prevention of cruelty to children or animals, the sum paid over by said trustees to such corporations or boards of trustees to be held by such corporations and boards of trustees in trust, and the income thereof to be expended for the general purposes for which such corporations and boards of trustees are organized, and I request that said funds be desig-

named by each corporation or board of trustees as the Henry Clay Jackson Fund.

The first property received by the petitioner under the deed of trust was received on May 29, 1923. (R. 24.) The total value of property received under the trust deed is not shown, but it was apparently quite substantial. Upon receipt of the first trust principal by the petitioner, separate accounts were opened for principal and for income (exclusive of gains from sales of corpus, which were carried in the principal account). The principal account has always been maintained separate and apart from the income account, and no annuity payments or payments to charities have been charged to the principal account. (R. 24.) The amount of trust income which the petitioner in its judgment considered to be available each year for payment to charities as not "jeopardizing the annuities", the amount appropriated to charities each year, and the years and amounts of payments to charities are stipulated. (R. 24–25.)

The income account of the trust disclosed an unexpended balance at January 1, 1931, the beginning of the taxable year involved, of $187,999.43. (R. 24, 38, 60.) During the year 1931, the trust received net income of $164,339.39. (R. 23, 38–39, 60.) Of this amount, $61,481.32 represented gains from sales of corpus which were added to the capital account and the balance of $102,858.07 represented income from other sources which was credited to the income account. (R. 13, 15, 23, 25, 38–39, 60.)

During the year 1931, the trust expended $212,862.80 from the income account, of which $22,350 represented annuity payments and $190,000 represented the payments to charities involved in this proceeding. This left a balance of $89,553.99 in the income account at the close of the taxable year. (R. 25, 39, 60.) There is no dispute that the $190,000 was paid to institutions which are charitable within the meaning of Section 162 (a) of the Revenue Act of 1928. (R. 26.)

The petitioner filed a fiduciary return for 1931 on Form 1041 showing the trust income apportioned to itself and to the annuitants. (R. 23, 35–36, 61.) It also filed an individual income tax return on Form 1040 for itself, as trustee, in which it reported as gross income the income apportioned to it on the fiduciary return and took a deduction of a like amount "Set aside for Charitable and Educational Purposes." Capital net gains from sales of trust corpus held more than two years were also reported in the individual return filed by the petitioner and shown as "Set aside for Charitable and Educational Purposes." (R. 23, 37–38, 61.)

In auditing the returns filed, the Commissioner of Internal Revenue determined net income to be $164,339.39, consisting of $61,481.32 representing gains from sales of trust corpus and $114,417.36 income from other sources. (R. 11–13, 23, 38–39, 60.) He allocated the entire net income and capital net gain to the petitioner, as trustee, allowing no deduction for payments to annuitants or pay-

ments to charities, and determined the deficiency in controversy. (R. 12–15.)

The Board of Tax Appeals sustained the Commissioner's action in disallowing the deduction for amounts paid to annuitants (R. 61–62), and that part of its decision was not appealed.

On the question of deductions for $190,000 paid to charities during the year, the Board of Tax Appeals held that the petitioner was entitled under Section 162 (a) of the Revenue Act of 1928 to deduct that part of the gross income for 1931 which was paid to charities, but found on the facts that not more than $2,000.57 of the gross income for 1931 had been used in making such payments. (R. 62–65.) Hence the Board allowed a deduction of $2,000.57. Both parties appealed to the Circuit Court of Appeals for the First Circuit.

In an opinion by Wilson, J., the Circuit Court of Appeals reversed the decision of the Board, and held that no part of the amount in controversy was deductible. The court put its decision upon the ground that deductions under Section 162 (a) must be distributions for charitable purposes which are directed to be made by the trustor, and not merely left to the discretion of the trustee. (R. 89–91.) Morton, J., who was of the opinion that the phrase "pursuant to the terms of the will or deed" in Section 162 (a) should be read as if it said "authorized by" the terms of the will or deed, dissented with no citation of direct authority. (R. 93.)

ARGUMENT

The only question involved in this proceeding is the narrow question whether the petitioner is entitled to deduct from gross income for 1931 the sum of $190,000, or any part thereof, as "any part of the gross income, without limitation, which pursuant to the terms of the will or deed creating the trust, is during the taxable year paid or permanently set aside for the purposes and in the manner specified in section 23 (n), or is to be used exclusively for religious, charitable, scientific, literary, or educational purposes" within the meaning of Section 162 (a) of the Revenue Act of 1928.

The trust instrument here permits the trustee whenever the net trust income for a year is equal to twice the amount required for annuities, to pay to charities "such sums as in their judgment may be paid without jeopardizing the annuities." (R. 33.) The Commissioner does not deny that such payments as were made to charities by the trustee were *authorized* by the terms of the trust, nor on the other hand does the petitioner contend that such payments were *directed* to be made by the trustor. The position of the Commissioner in disallowing the deduction, and before the Board of Tax Appeals and Circuit Court of Appeals, was that it is not every authorized payment to charity which is deductible, but only those payments which within the language of Section 162 (a) are made or permanently set aside from "any part of the gross

income" and "pursuant to the terms of the deed." The petitioner to sustain the claim of deduction has necessarily contended that Section 162 (a) should be construed to permit the deduction of amounts paid under the discretionary authority granted it by the terms of the trust. It is the position of the Commissioner that only those payments directed to be made by the trustor are deductible.

The Circuit Court of Appeals in ruling against the petitioner followed the decision in *Charles P. Moorman Home for Women et al.* v. *United States*, 42 F. (2d) 257 (W. D. Ky.), and quoted with approval the following statement of the law from that case (pp. 260, 261):

> The quoted language of section 219 of the act of 1918 makes it clear that the trust income, to be exempt from taxation as a charitable contribution, must be paid to or permanently set aside during the taxable year for a corporation organized and operated exclusively for charitable purposes, and that such payment or permanent setting aside must be pursuant to the terms of the instrument creating the trust. In other words, the instrument creating the trust must make it clear that it was the intention of the creator of the trust that such income should be paid during the taxable year to the charitable corporation or permanently set aside to it during such taxable year. The statute makes it very clear that it was not the intention of Congress to make the taxability of the income for any taxable year depend

upon the discretion of the trustee in paying or permanently setting aside the income of the trust to the charitable purpose during the taxable year, but to depend solely upon the provisions of the instrument creating the trust.

* * * * *

Section 219 (b) of the Revenue Act of 1924 grants the exemption, not only in cases where the income has been paid to or permanently set aside for the charitable purpose during the taxable year, but also in those cases where the income received during the taxable year is to be used exclusively for the charitable purpose. As in the acts of 1918 and 1921, however, the determining factor is the instrument creating the trust, and not the discretion of the trustee. Therefore, under the 1924 act, unless it appears from the instrument creating the trust that the income from which exemption is sought is set aside in the instrument creating the trust exclusively for a charitable purpose, or under the terms of that instrument is to be paid during the taxable year or permanently set aside during that year for the charitable purpose, it is not exempt. (R. 89, 90.)

The construction of Section 162 (a) followed by the Circuit Court of Appeals gives full effect to the plain language of the statute. Congress when it meant discretion of the trustee expressly so stated in Section 162 (c) which follows almost immediately after the provision in question here. (Appendix, p. 17.)

Deductions under Section 162 (a) for amounts which pursuant to the terms of a trust deed are permanently set aside for charitable purposes cannot be had when such amounts in the discretion of the trustee under possible exigencies of the trust can be used for other than charitable purposes. *Boston Safe Deposit & Trust Co.* v. *Commissioner,* 66 F. (2d) 179 (C. C. A. 1st); *Guaranty Trust Company of New York* v. *Commissioner,* 31 B. T. A. 19. So too, as pointed out by the court below, it is settled in the case of estate taxes that specific gifts to charitable institutions are exempt, while charitable gifts left to the discretion of a fiduciary under the terms of the will are taxable. *Mississippi Valley Trust Co.* v. *Commissioner,* 72 F. (2d) 197 (C. C. A. 8th); cf. *Helvering* v. *Pardee,* Case No. 77, 290 U. S. 365, 370–1. The ruling of the court below is in full accord with both these lines of decision.

The Commissioner contended below that the deduction should be denied for an additional reason, namely, that the deed of trust did not direct that payments be made *from income.* It is settled that a trustee may not deduct payments to annuitants whose payments are not required to be made from income (*Helvering* v. *Pardee,* 290 U. S. 365), and the same principle should be applicable here. It is evident that Congress was dealing with the trustor's gifts of income, not with gifts made by the trustees. Accordingly, we submit that it is necessary to the allowance of a deduction that the

trustor identify the source of the gift as well as its object.

There is no conflict in the circuit courts of appeals on the narrow question determined in this proceeding. The petitioner suggests that the decision of the court below is in conflict with the decision of the Circuit Court of Appeals for the Second Circuit in *Hartford-Connecticut Trust Co.* v. *Eaton,* 36 F. (2d) 710. That case involved the question whether trust income had, pursuant to the trust instrument, been "permanently set aside" for charitable institutions within the meaning of Section 162 (a). Unlike this case where there is no direction by the trustor, the testator there had directed the disposition of the income, and the only question was whether his directions *definitely required* that income be "permanently set aside" for charitable purposes. The decedent had left the residue of his estate in trust, the income to be paid to his widow for life, the corpus to go to charities at her death. The will authorized the trustee to make payments to the widow from the corpus of the estate if "necessary or advisable for her comfortable maintenance and support." The trustee realized a capital gain in the sale of trust property which constituted income within the meaning of the revenue acts but which was corpus for the purposes of the trust. The collector argued that since the trustee was authorized to invade the corpus if necessary for the widow's support, the capital gain was not "permanently set aside" for charitable institutions. The Court construed the will as lim-

iting the trustee to the support of the widow in her habitual, thrifty, standard of living; and on demurrer interpreted an allegation of the taxpayer's complaint that "plaintiff would never have found it necessary to use the corpus for her (the widow's) support" to mean that the income was enough for that support according to her habit. 36 F. (2d) 710, 712. Whatever may be the correctness in that situation of the court's decision that the capital gain was "permanently set aside", it has no application here. The ruling but illustrates on the affirmative side the principle of *Boston Safe Deposit & Trust Co.* v. *Commissioner,* and *Guaranty Trust Company of New York* v. *Commissioner,* both *supra,* and in any event is certainly not in conflict with the decision of the court below. Neither the majority nor the one dissent below cited *Hartford-Connecticut Trust Co.* v. *Eaton* as opposed to the ruling of the court below, although that case was strongly urged in petitioner's brief. Morton, J., who dissented below, did so, to use his language, on "a very narrow question, depending on what is meant by the statutory expression, 'pursuant to the terms of the will or deed.'" (R. 93.) He merely was of the opinion on the basis of the meaning thought to be given to "pursuant to" in two old statutes and indictments unrelated to the necessities of a workable scheme of taxation, that these words should be read as if they were "authorized by."

Whether the income "is to be used exclusively for religious", etc., purposes within the meaning

of the statute raises no separate question. This provision permits deductions of income which, though not contributed directly to corporations, trusts, community chests, etc., meeting the requirements of Section 23 (n), "is to be used" for the stated purposes in some other manner. It seems clear that if it is required in the one case that contributions must be specifically directed by the deed of trust, the same requirement is attached to the deduction of income which is to be used for stated purposes otherwise than by contributions to such corporations, trusts, or community chests.

CONCLUSION

The decision of the Circuit Court of Appeals is correct, follows direct authority, and is uniform with settled rules in closely related fields of Federal taxation. There is no conflict of authorities, nor any broad or doubtful question of great moment to be settled. The petition for certiorari should be denied.

Respectfully submitted.

STANLEY REED,
Solicitor General.
JAMES W. MORRIS,
Assistant Attorney General.
SEWALL KEY,
J. LOUIS MONARCH,
F. E. YOUNGMAN,
Special Assistants to the Attorney General.

MARCH 1937.

APPENDIX

Revenue Act of 1928, c. 852, 45 Stat. 791, 801, 838:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(n) *Charitable and other contributions.*—In the case of an individual, contributions or gifts made within the taxable year to or for the use of:

(1) the United States, any State, Territory, or any political subdivision thereof, or the District of Columbia, for exclusively public purposes;

(2) any corporation, or trust, or community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual;

(3) the special fund for vocational rehabilitation authorized by section 7 of the Vocational Rehabilitation Act;

(4) posts or organizations of war veterans, or auxiliary units or societies of any such posts or organizations, if such posts, organizations, units, or societies are organized in the United States or any of its possessions, and if no part of their net earnings inures to the benefit of any private shareholder or individual; or

(5) a fraternal society, order, or association, operating under the lodge system, but only if such contributions or gifts are to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals; to an amount which in all the above cases combined does not exceed 15 per centum of the taxpayer's net income as computed without the benefit of this subsection. Such contributions or gifts shall be allowable as deductions only if verified under rules and regulations prescribed by the Commissioner, with the approval of the Secretary. (For unlimited deduction if contributions and gifts exceed 90 per centum of the net income, see section 120.)

SEC. 161. IMPOSITION OF TAX.

(a) *Application of tax.*—The taxes imposed by this title upon individuals shall apply to the income of estates or of any kind of property held in trust, including—

(1) Income accumulated in trust for the benefit of unborn or unascertained persons or persons with contingent interests, and income accumulated or held for future distribution under the terms of the will or trust;

(2) Income which is to be distributed currently by the fiduciary to the beneficiaries, and income collected by a guardian of an infant which is to be held or distributed as the court may direct;

(3) Income received by estates of deceased persons during the period of administration or settlement of the estate; and

(4) Income which, in the discretion of the fiduciary, may be either distributed to the beneficiaries or accumulated.

(b) *Computation and payment.*—The tax shall be computed upon the net income of the

estate or trust, and shall be paid by the fiduciary, except as provided in section 166 (relating to revocable trusts) and section 167 (relating to income for benefit of the grantor). For return made by beneficiary, see section 143.

SEC. 162. NET INCOME.

The net income of the estate or trust shall be computed in the same manner and on the same basis as in the case of an individual, except that—

(a) There shall be allowed as a deduction (in lieu of the deduction for charitable, etc., contributions authorized by section 23 (n)) any part of the gross income, without limitation, which pursuant to the terms of the will or deed creating the trust, is during the taxable year paid or permanently set aside for the purposes and in the manner specified in section 23 (n), or is to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, or for the establishment, acquisition, maintenance or operation of a public cemetery not operated for profit;

(b) There shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to the beneficiaries, and the amount of the income collected by a guardian of an infant which is to be held or distributed as the court may direct, but the amount so allowed as a deduction shall be included in computing the net income of the beneficiaries whether distributed to them or not. Any amount allowed as a deduction under this paragraph shall not be allowed as a deduc-

tion under subsection (c) of this section in the same or any succeeding taxable year;

(c) In the case of income received by estates of deceased persons during the period of administration or settlement of the estate, and in the case of income which, in the discretion of the fiduciary, may be either distributed to the beneficiary or accumulated, there shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is properly paid or credited during such year to any legatee, heir, or beneficiary, but the amount so allowed as a deduction shall be included in computing the net income of the legatee, heir, or beneficiary.

Treasury Regulations 74, promulgated under the Revenue Act of 1928:

ART. 862. *Method of computation of net income and tax.*—The Act provides that the tax computed upon the net income of the estate or trust shall be paid by the fiduciary, except as provided in sections 166 and 167. (See article 881.) However, in computing the net income of the estate or trust, the following deductions will be allowed either in addition to, or in lieu of (as the case may be), those specified in sections 23, 119, 213, and 251 in the case of individuals:

(1) If the terms of the will or of the deed creating the trust direct that any part of the gross income of the estate or trust (a) be paid or permanently set aside for charitable or other purposes, as specified in section 23 (n), or (b) be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, or for the establishment, acquisition, maintenance, or

operation of a public cemetery not operated for profit, such gross income so paid or set aside during the taxable year shall be allowed as a deduction in lieu of the deduction authorized by section 23 (n).

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